

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

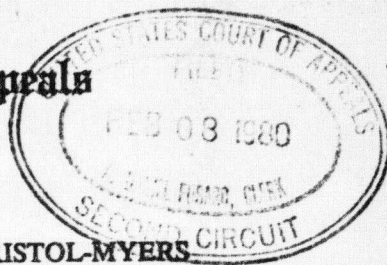
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To be argued by:
ROBERT L. SHERMAN

United States Court of Appeals
For the Second Circuit



**BRISTOL LABORATORIES DIVISION OF BRISTOL-MYERS
COMPANY,**

Plaintiff-Appellee,

against

**ELMER B. STAATS, COMPTROLLER GENERAL OF THE
UNITED STATES,**

Defendant-Appellant,

and

UNITED STATES OF AMERICA,

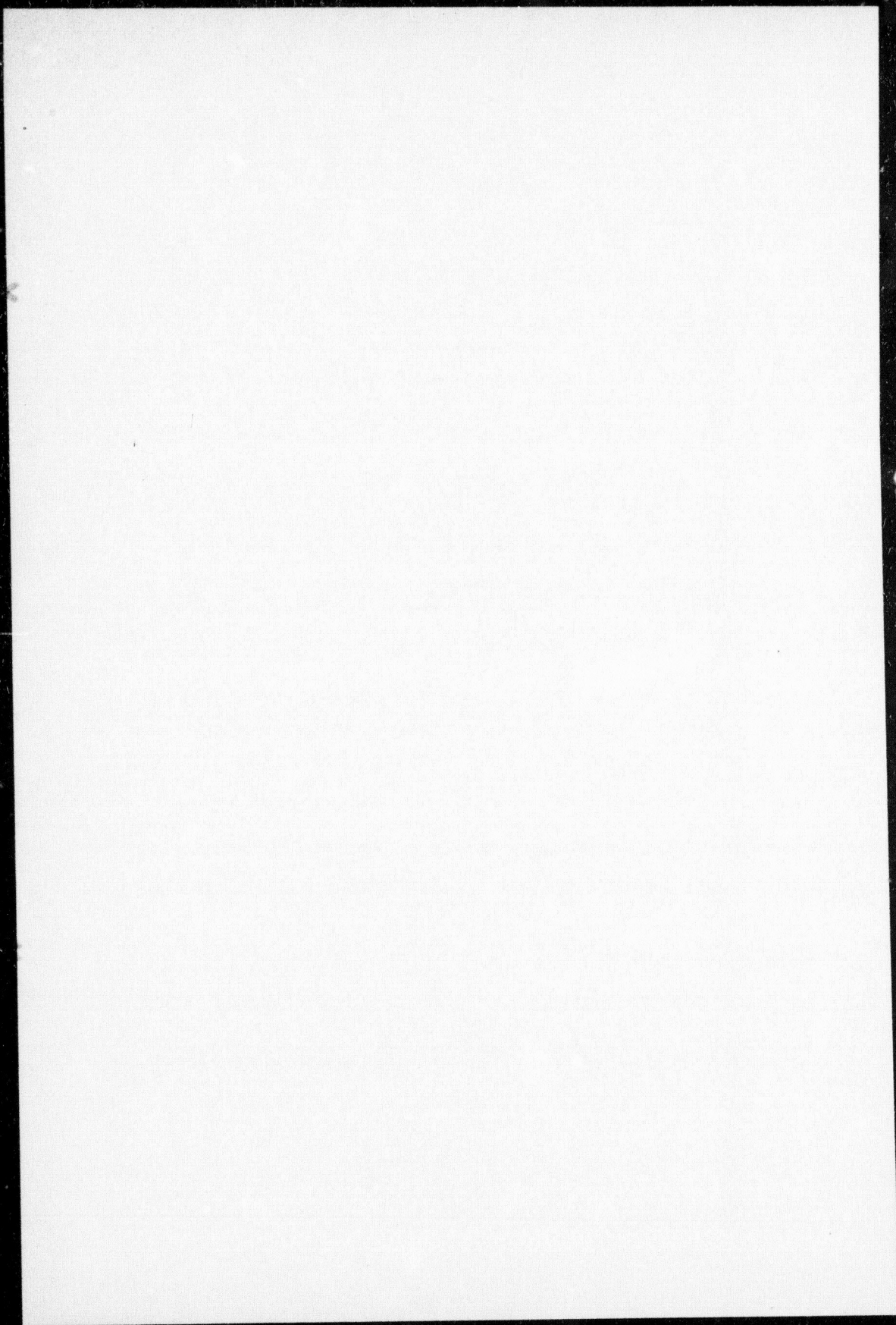
Intervenor-Defendant-Appellant.

**BRIEF OF APPELLEE BRISTOL LABORATORIES
DIVISION OF BRISTOL-MYERS COMPANY**

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**BRIEF OF APPELLEE BRISTOL LABORATORIES
DIVISION OF BRISTOL-MYERS COMPANY**

Preliminary Statement

This is an appeal by the Comptroller General of the United States and the United States of America from a judgment entered and filed on July 15, 1977 (A 4-6) following a memorandum opinion of the United States District Court for the Southern District of New York, Lasker, *J.*, filed on April 11, 1977 (A 7-17), and reported at 428 F. Supp. 1388.

Issue Presented

Whether records reflecting costs which were neither taken into account and included by appellee (sometimes "Bristol") in setting its prices to the government in the

subject contracts nor incurred and passed on to the government in Bristol's performance thereof are records that are "directly pertinent" thereto within the meaning of said subject contracts.

Statement of the Case

A. Nature of the Case¹

During the years 1973 and 1974 appellee ("Bristol") entered into contracts with the Veterans Administration and with the Department of Defense of the United States for the sale of certain pharmaceutical products (A 65-66). As required by 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c), each of those contracts incorporated a provision relating to the examination by appellant Staats of certain books and records of appellee.

In relevant part such clause reads:

The Contractor agrees that the Comptroller General of the United States . . . shall . . . have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.

The pivotal fact in this case, and one that distinguishes it from every authority relied upon by appellants, and which nullifies every crucial argument they make, is that appellee's pricing of the subject contracts *excluded* as factors any costs, such as general and administrative, research and development, distribution, or promotion other

¹ This section of appellee's brief also includes the underlying operative facts involved herein. For a concise statement thereof, see A 65-67 and 180-81.

than Bristol's estimated "standard costs", its historical bidding and competition (*infra*, pages 8-12, 14).²

By letter of August 26, 1974, to Mr. Richard L. Gelb, Bristol's President and Chief Executive Officer, appellant Staats, purporting to act pursuant to his statutory authority and under the contracts between Bristol and the government, formally requested that it make available to appellant's representatives all records directly pertinent to the subject contracts (A 71-77). Bristol affirmatively responded by letters dated September 13, 1974 from Mr. Douglas R. Purdy to appellant (A 78), and November 18, 1974 from Mr. Purdy to Mr. Gregory J. Ahart, Director, Manpower and Welfare Division, United States General Accounting Office (A 79-80), indicating its willingness to do so.

Bristol did not then and does not now dispute that appellant Staats "is entitled . . . to examine any *directly* pertinent . . . records of [appellee] . . . involving transactions *related to* such contract[s] . . ." (emphasis supplied). That is the only extent of appellee's obligation under the subject contracts and is exactly the delimitation of appellant's authority under the statutes. But appellant is not willing to stop there.

Following the aforementioned correspondence, appellant's representatives met with Bristol's representatives at the latter's offices in Syracuse, New York on February 10

² While Lilly (*infra*, pages 16-19) and Abbott (*infra*, pages 19-20) speak of the manufacturer as not "assigning" certain expenses to any particular product, they do not indicate that such costs were excluded in determining the price to the government, as distinct from *post hoc* corporate accounting. Here the record is clear that Bristol's exclusion of general and administrative, research and developmental, distribution and promotional expenses was not just an aspect of its accounting processes, but was a factor in setting the very prices in the subject contracts (*infra*, pages 10-11, 14).

and 11, 1975, (A 67). Bristol made available for examination all of its records which directly pertain to, and involve transactions related to, the subject contracts. When appellant Staats's representatives sought access to records beyond those definitions Bristol denied their demand.

On March 6, 1975, appellant Staats, reciting his version of the above events, informed Bristol that if his formal request for records were not satisfied he would take appropriate action (A 81-82). In response thereto, Bristol's counsel, in a letter to appellant Staats under date of March 18, 1975, clearly and succinctly restated its position of willingness to provide all, but only, such records as were directly pertinent to, and involved transactions related to, the subject contracts (A 83-84). Bristol then instituted the within action for a declaration of its legal rights.

In short, the controversy herein is over the boundaries set by the limiting words "directly pertinent" and "related to" found in the contracts. As a matter of law they do not encompass records of costs involving transactions which are not "directly pertinent" or "related" to Bristol's government contracts.

Appellants, however, reject that definition, and rely on a "bottom line" theory. They contend they are entitled to all records of costs which might ultimately be recovered from total corporate revenues, including those from government contracts. Since all of Bristol's costs are recovered from all of its revenues, the Comptroller General's theory would provide him access to virtually all of its records of all of its costs, no matter how remote they might be from the subject contracts, and regardless that they were *excluded* from calculation of Bristol's pricing in them. The district court saw through appellants' bootstrap approach:

In other words, revenues from government contracts are co-mingled with revenues from non-gov-

ernment contracts, and the resulting fund is used to pay for all expenses. If the government's interpretation of the access to records clause is correct, Bristol will be required to make available virtually all of its books and records because although it is impossible to trace the use of government dollars, those dollars contribute to the fund from which all of the company's expenses are paid.

Such a result would be inconsistent with the language of the access to records clause and the statutes pursuant to which the clause was included in the contracts. 428 F.Supp. at 1390.

Under appellants' "bottom line" theory, if General Motors were to enter into one insignificant contract with the government, the Comptroller General would be permitted access to all of GM's cost records since the revenue generated from even that one contract contributes to GM's general revenue pool which, in turn, is available to "recover" all or any of GM's costs in its journey toward a "bottom line". Rather than stopping at some higher, "directly pertinent" line, appellants would follow the government-generated revenue as it wended down to the overall corporate "bottom line" and would demand access to every cost that it might have met en route. To accept appellants' theory would be to interpret the statutorily dictated contractual language³ so as to render congress's explicit confinements fruitless. The district court properly found such a self-defeating construction improper, concluding that the term "directly pertinent" must be given a responsible and a reasonable meaning.

The purpose of appellants' "bottom line" approach is plain. Appellant Staats wants to conduct a full-scale

³ 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c).

economic survey of the pharmaceutical industry.⁴ Lacking intentional congressional authorization to do so, he now tries to bend the statutorily prescribed access-to-records clause to that end. In the process of his attempt to increase the kinds of records to which he may gain access, perhaps pertinent to his unauthorized survey but not to reviewing the negotiation of the subject contracts, the Comptroller General has created the problem that lies at the heart of this lawsuit, and now of this appeal.

His "bottom line" theory is little more than an attempt to overshoot the statutory authority given to him and to gain access to records beyond those to which he is entitled. As Judge Lasker has found, and as will be further amplified, appellants' demand is made without legal or factual basis.

It is a distortion of the ["directly pertinent"] language to argue that these words permit GAO officials to discover virtually everything there is to know about the structure of the contractors' business. The reasonable assumption is that if Congress had wished to condition the receipt of a fixed-price negotiated contract on the contractor's agreement to allow such unusual and unfettered government inspection of their business records, it would have done so explicitly. 428 F.Supp. at 1390.

Moreover, the government's overreaching is particularly inappropriate and groundless in view of the facts under which Bristol operates (see pages 8-13, *infra*).

B. The Course of Proceedings

Each party at first moved for summary judgment. The thrust of those motions was to obtain a judicial interpretation of the limiting term "directly pertinent" as it relates

⁴ See affidavit of James D. Martin (A 105-07).

to the subject contracts in the context of Bristol's operations and records. In an unpublished opinion dated December 31, 1975 (A 18-23), the district court initially denied those motions on the ground that critical factual questions existed. Those questions were concisely presented in a single paragraph on page 4 of the court's memorandum:

Without information as to how [research and development; advertising and promotion; general and administrative; and distribution] costs are recovered, what Bristol's research and development, and marketing and promotion activities entail, or its method of accounting, it is impossible to determine the correctness of either party's position.

The court then suggested to appellants how to proceed:

The proper course to follow is to restrict initial discovery by the Comptroller General to deposition of knowledgeable officials of Bristol Labs as to Bristol's methods and procedures for allocation of costs of all items not allocated exclusively to non-government contracts.

Thus, the responsibility for eliciting sufficient facts to support their burden of proof was properly recognized to rest with appellants.

In an effort to answer those questions appellants, on April 6, 1976, deposed Bristol by its Vice President and Controller, Richard J. Cormier. His testimony confirms the factual basis supporting Bristol's position. (A 119-73.)

Having been presented with the issues as refined by the court, and having failed to prove their case, appellants' motion for summary judgment was denied, and appellee's granted. The judgment from which the government now appeals was entered on July 15, 1977 (A 4-6).

Argument

- A. The district court properly found that Bristol's mode of operation and resultant method of accounting demonstrate that appellant Staats's demands for access to certain records are outside the scope of what legally may be considered "directly pertinent".**

The government would have this Court believe that Bristol's bookkeeping procedures are "irrelevant and fortuitous" in relation to the manner in which Bristol transacts its business, and that the district court's decision, relying principally upon those procedures, ignores the facts they purport to reflect. Such a proposition flirts with fantasy, if not with absurdity. One need only appreciate the legal and operational restrictions on Bristol to maintain accurate financial records to reject the government's contention; one need only read Judge Lasker's opinion to appreciate his valid comprehension of the underlying operative facts here involved. Bristol's method of accounting accurately reflects its business operations which do not factor in expenses for research and development, advertising and promotion, distribution or general and administrative costs when setting prices in contracts with the government. Accordingly, its accounting method is based on a system of "standard costs".⁵ Those costs actually are estimates of what the costs of raw materials, packaging materials, labor, machinery and factory overhead will be for a particular product during a given calendar year (A 139-40).⁶ A

⁵ Expenses such as general and administrative, research and development and advertising and promotion are independently accumulated as separate division-wide totals and are not included in the standard costs. (A 145-49.)

⁶ See, specifically, A 139, line 24 through A 140, line 13.

comparison of those estimates ⁷ (standard costs) and any variances with income determines gross profit to the company. That is the way Bristol operates its business; that is the way Bristol keeps its books.

Q. Are direct manufacturing costs allocated to products?

Let me rephrase that.

Are all costs which are included in what you call standard costs, are those costs allocated to products?

A. Are you referring to actual costs, or are you referring to estimated costs?

Q. Let's do one at a time. First the standard costs, are those allocated to particular products? A. In the standard costs which are estimated costs, they are allocated to the standards.

Q. And the variances, are those allocated to products, the variances from the standard costs? A. No.

Q. To what, if anything, are variances from the standard costs allocated? A. They aren't. Variances become a central variance account.

Q. Of Bristol Laboratories? A. Right. We could have some type of variances, but not in any way allocated by product.

Q. Are research and development costs allocated to any product line or product of Bristol Laboratories, or are research and development costs solely allocated to Bristol Laboratories as a totality? A. They are not allocated.

Q. Is the same true for general administrative costs? Are those also unallocated? A. Unallocated.

Q. The same for advertising and promotion costs or not? A. In one of our internal reports used for

⁷ Actual costs are recorded as they are incurred. To the degree they differ from standard costs they contribute to a central variance pool, but are not accounted by product (A 139, lines 17-23). Bristol, however, does not deny that records of variances are pertinent.

compensation purposes, we do attempt to identify some of the advertising promotion costs by product, not by customer type, but by product. (A 149, line 5—A 150, line 17).

This identification of advertising and promotion expenses, used for the limited purpose of reviewing employee compensation, did not find its way as a factor into the costs or negotiation of the subject contracts and therefore was not "allocated" in the pertinent sense intended by appellants of elevating prices to the government.

Research and development expenses are not allocated to products for good reason. They do not relate to products that are currently being sold, but rather to *projects* that may *or may not* develop into products sometime in the future (the very reason they are treated as period expenses and not as indirect manufacturing overhead):

Q. Why do you treat research and development costs as periodic expenses rather than as an indirect manufacturing overhead? A. Research expenses do not really apply to products that were [sic] currently selling. They apply to products we hope some day will come into the marketplace. Therefore, there is no real way to apply them against any products we are selling at present.

Q. I assume at certain times at least there is continuing research or development with respect to a current product. In that case, do you assign a computerizing [sic] research cost to the product or nonetheless continue to treat it as a period expense? A. We still treat it as a period expense because the additional research is undoubtedly for a new claim that doesn't exist, and therefore it doesn't apply to the existing product. (A 155, line 14—A 156, line 6)

Besides not being allocated, expenses such as general and administrative, research and development and advertising and promotion are not considered variances.

When asked what method was employed by Bristol in establishing its prices to the government for items sold under the subject contracts, Mr. Cormier responded:

We would look at the estimated standard cost for the product in question. We would look at historical bidding on our part and on the part of our competition, and basically these are the factors that would allow us to render a decision on what price should be bid for a given contract. (A 166, lines 9-14.)

Bristol always has been, and it remains, willing to make records reflecting those factors (and elements contributing to them) available to appellant Staats.

Mr. Cormier first testified that revenue generated from non-government sales helps cover business expenses during a given financial reporting period. When subsequently asked, however, whether revenue generated from government sales contributes, along with revenue from non-government sales, to the recovery of all costs of doing business during a financial period, Mr. Cormier responded:

I don't believe that we have any way of really telling . . . We can't really determine what income applies to what expenses. (A 168, lines 3-9.)

The distinction between those two answers perhaps best reveals one of appellants' grossest misconceptions of Bristol's business. While as a commingled, unidentifiable part of a grand total (all revenue from all sources) revenue from sales to the government goes toward covering Bristol's business expenses during a given period, there is no

way of knowing, and there are no records showing, revenues from which sources contribute to the recovery of which costs and expenses. Mr. Cormier articulated that very clearly. The government must not be permitted to brush it aside by the device of some catch-all "bottom line" theory to see what would amount to virtually every income and expense record Bristol keeps. The controlling fact is that even if any part of income from the subject contracts conceivably could have offset any Bristol expense, it is only those expenses that were taken into account in arriving at the subject contracts' prices that would be "directly pertinent" to them.

Congress could not have intended by its use of so confining a descriptive as "directly pertinent" to let the Comptroller General ramble through all corporate records of all corporate revenues and costs.

If Bristol was satisfied to take no costs other than its "standard" ones (as defined at pages 8-9 above, 14 below) into account in negotiating the subject contracts, then none other than those are "directly pertinent" to such "transactions". And, certainly, no harm is done to the Comptroller General's responsibility and core interest to monitor the reasonableness of Bristol's prices to the government if circumstances make data of such non-allocated costs unavailable to him. Excluding cost items from the calculation of prices can put only downward pressure on them to be fair. It would be only inclusion of additional costs to increase prices that could raise questions as to unfairness in charging them.

Inquiry by the Comptroller General into such other, but unincorporated, expenses, on an unsubstantiated assertion that they are somehow "directly pertinent" to the transactions at bar, even if it were feasible, would enhance, but could

not impugn the fairness of Bristol's prices. Absent those costs Bristol's prices stand in their poorest light for reasonableness. If the Comptroller General might find additional expenditures that could have been assigned to the subject transactions, but were not, that would only make Bristol's prices, which did not allow for them, all the more reasonable by shrinking its gross profit on them.

B. The cited decisional law, to the extent it is relevant, supports Bristol, not appellants.

Staats "is entitled . . . to examine any *directly* pertinent . . . records of [Bristol] . . . involving transactions *related* to [the subject] contract[s] . . .".⁸ Bristol recognizes that as its remaining obligation under the subject contracts and intends to honor it. But appellant Staats wants much more than that, and accuses Bristol of attempting to "frustrate" a legitimate government examination through its accounting procedures.

Bristol has been operating its business in the manner described by Mr. Cormier since long prior to the commencement of the instant litigation, and likely will continue to do so for a long time after its completion. Its operational methods are well established, and are widely accepted and used by many other manufacturing operations. Regardless, appellants would ignore them and have Bristol make available for examination virtually every record in its possession. And all this under the banners of "directly pertinent" and transactions "related to" specific contracts, although Bristol's pricing under the subject contracts did not involve the data that presumably would be reflected by those records.

⁸ 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c); emphasis added.

The MacBeth affidavit (Mr. Lorne C. D. MacBeth is the Vice President—Marketing of Bristol Labs) and the Cormier testimony set forth the factors considered by Bristol in setting its prices under the subject contracts:

In setting prices to the government, Bristol Laboratories considers manufacturing costs such as: raw and packaging materials, labor and fringe benefits, quality control and supervision; manufacturing overheads such as: plant administration, production planning, warehousing, utilities, and security; royalty expense; and, in a general way, the cost of delivery to the sites specified in the contract.⁹

Those are the sole factors that affected the prices to the government. They are, therefore, the only factors that are "directly pertinent" to the subject contracts. Bristol is willing to make records of them available to appellant Staats. In so doing it would fulfill its contractual and statutory obligations. Judge Lasker agreed.

Pivotaly important is Bristol's exclusion of other expenses in setting the subject contract prices:

Bristol Laboratories does not consider expenses incurred for research and development; advertising and promotion; general and administrative; and distribution (except as set forth in Paragraph 4) in setting contract prices to the Federal Government.¹⁰

Those expenses simply are not pertinent (and certainly are not *directly* pertinent) to the subject contracts. They formed no part of, had nothing to do with, those transactions. Nothing the Comptroller General says or does makes them pertinent.

⁹ A 117-18; see, 428 F.Supp. at 1389.

¹⁰ A 118.

Accordingly, Bristol's governmental contractual operations do not include allocation of research and development, general and administrative, advertising, distribution and promotion expenses. Its accounting records merely track its operations. Appellants' "bottom line" approach concerns only post-contract accounting procedures. It has no relevance, no direct pertinence, to the contracts themselves.

Appellants argue that *Hewlett-Packard v. United States*, 385 F.2d 1013 (9th Cir. 1967) supports their position and was misconstrued by the district court. A fair reading of that case, however, clearly indicates that the Ninth Circuit was not concerned with the Comptroller General's right to access to a contractor's records of costs not involved in negotiating or incurred in fulfilling a government contract. Thus, the case has no value to appellants here.

To the extent that it may be relevant, it supports Bristol, for it limits the records to which the Comptroller General may gain access to those "relating to the *cost of producing the items* furnished by Hewlett-Packard Company *under the aforesaid contracts*, including costs of *direct* material, *direct* labor and overhead costs".¹¹ The United States was, accordingly, not permitted so expanded an examination of records as it seeks in this case.

The fact is that the *Hewlett-Packard* court approved access only to standard manufacturing costs.

Production costs directly pertain to that subject matter . . . Production costs involve transactions relating to the contract, because they encompass business arrangements made by the contractor in obtaining the materials, labor, facilities and the like required by it in fulfilling its commitment with reference to the subject matter of the contract. 385 F.2d at 1016.

¹¹ 385 F.2d at 1016 (emphasis supplied).

Hewlett-Packard aligns to perfection with Bristol's position and with the district court's decision in this case. The effectiveness with which government negotiators represent the interests of the public is a function of the ratio of the supplier's gross profit on a subject contract to the contract price; not of what the company does with that gross profit after realizing it. That gross profit is the difference between the contract price and the costs involved in the transactions that directly pertain to performing under the contract. The records Bristol agrees are accessible to appellant Staats will enable him to audit its gross profit on the subject contracts.

Appellants claim great comfort from *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir. 1978). It is ill taken. *Lilly* involved a matrix of facts and legal arguments not presented here and which have only a superficial relationship to the subject appeal. The main thrust of Lilly's argument was that the government was attempting to conduct an unauthorized and unlawful economic survey of the entire pharmaceutical industry. In a majority opinion that ran on for some thirteen pages, a divided court went through legal contortions to support the government's undertaking. It even went so far as to rely not only on statutes that were not cited by either party, but also on others that seemed to have been abandoned by the government during the litigation.

But getting past the legal attenuations of the majority, one immediately recognizes that the *Lilly* court did not address the substantive issues decided by Judge Lasker in this case, and was not equipped with the same operative facts he had and on which they might have based a full and considered application of legal principles to specific facts.¹²

¹² It is notable that two of the three judges in *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979) made clear that they would have decided *Lilly* the other way had they sat upon it; and they held as they did in *Abbott* only because of the constraint of *stare decisis*. *Id.* at 674-75.

There the court found that among Lilly's major items of cost in producing and marketing its products to the government were included some of those in dispute on this appeal, namely research and development.¹³ As has been demonstrated by uncontroverted and uncontrovertible testimony, the same is not true of Bristol. (See pages 8-12, and 14 *supra*, describing Bristol's mode of operation and factors considered in setting its prices to the government.) Accordingly, *Lilly*, like *Hewlett-Packard*, is of little value to this Court.

Bristol agrees with Lilly, of course, that an investigation by the Comptroller General motivated by an improper purpose should not be judicially endorsed. However, Bristol's assault is less upon the Comptroller General's motivation than on his lack of authority, as a matter of law, via the access-to-records clause as incorporated in Bristol's contracts with the government, to rummage through data as to costs that were *excluded* as factors from its subject contracts and their prices. *Lilly* did not deal with that. Neither did *Hewlett-Packard* nor *Abbott*.

Yet, with all that was said in *Lilly* that must be considered extraneous to the issue here on appeal, at the close of that section of the majority opinion entitled "The Meaning of the Statutes" *Lilly's* majority sets forth its view of the meaning of "directly pertinent" by stating "The access-to-records clause should be interpreted so that an item is 'directly pertinent' to a contract *if it is a significant input in the cost of the product purchased in the contract*" (emphasis added).¹⁴ Bristol agrees.

Lilly also recognized "If such costs constituted a *minimal share of the total price* of the contract, it might be difficult to argue that these costs are 'directly pertinent' to the

¹³ 574 F.2d at 914.

¹⁴ *Id.* at 914-15.

price of the contract as a whole, *but that issue does not seem to be presented on these facts.*" (Appellants' Brief, page 14; emphasis ours.) Here, the facts *do* present that issue; and they establish that the involved costs constituted less than a "minimal share" of the total contract prices. It was a zero share.

The vigorous dissent in *Lilly* characterized the majority opinion as an "extension of the Big Brother concept into legitimate privacy in the industrial field" and pointed out that the majority "strains to find justification for the Comptroller's broadsweeping attempt to delve into information in excess of his authority under law". (574 F.2d at 918.)

It then goes on, in addressing the *Hewlett-Packard* decision, to state:

That the majority opinion is relying more on the *holding* of that case than the acuteness or depth of the analysis appears rather clear from a comparison of the length of *Hewlett-Packard* [less than four pages] with the majority opinion in the present case [thirteen pages]. *Id.* at 918-19.

It continues by questioning the correctness of the analysis set forth in *Hewlett-Packard*¹⁵ and by making reference to the *Bristol* case^{15a} and another case pending in the district court for the District of Columbia, *Merck & Co., Inc. v. Staats*, Civil Action No. 74-1447. The dissent's conclusion is that the *Bristol* reading of the statutes and access-to-records clauses should have been an appropriate stopping place for *Lilly* as well.

¹⁵ The dissenting judge agreed with the majority's analysis of *Hewlett-Packard* that the Ninth Circuit's interpretation of the word "contract" is tortured and that the key words are "directly pertinent", *id.* at 919.

^{15a} The district court's decision herein.

Lilly obviously could not have been concerned with Bristol's method of setting prices to the government in the subject contracts.¹⁶

The third and final appellate decision that the government relies on is a *stare decisis* adherence to, while disagreeing with, the *Lilly* case. Of the three-judge panel in *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979), only one wrote the court's holding while the majority of two evidently rejected its rationale and seemingly deplored its result (*id.* at 674-75). The sole issue in *Abbott* was whether that case was controlled by the same circuit's prior decision in *Lilly*. The judge writing the majority opinion held that it was and that the urged distinction between *Lilly*, which dealt with the government's two purposes for seeking information, and *Abbott*, which dealt with only one of them (the alleged unlawful economic survey of the pharmaceutical industry) was insufficient.

The same judge that wrote the dissenting opinion in *Lilly* felt bound to follow that decision in *Abbott* notwithstanding that in his view it was erroneous.

I have no choice but to follow the law, which in my opinion, if this had been an *a priori* matter, the Comptroller General was not doing. I therefore, albeit unhappily, concur in the foregoing opinion by Judge Sprecher. 597 F.2d at 675.

A second judge insisted on filing a separate concurring opinion, stating, in its entirety:

I concur *only* because I am bound by this court's prior decision in *Lilly*, in which I did not participate. *Ibid.* (Emphasis ours.)

¹⁶ Lilly's corresponding mode, method and factors were not discussed by the court, except to the extent that it found research and development to be a factor in Lilly's setting of prices, which is not the case here.

The inferences that may be drawn from the *Lilly* opinion, its accompanying dissent, and the two concurring opinions in *Abbott* should be caution enough for any other court not to adopt *Lilly* without careful independent scrutiny. The established facts of record regarding Bristol's operations and how it set its prices under the subject contracts not only underscore that caution, but require independent application of law to crucially distinguishable facts.

Far from being a case on "all-fours" with the instant one (Appellants' Brief, page 12), *Lilly* addressed questions alien to the issues presented to this Court. Beyond that, it could not have considered the controlling fact that particular periodic expenses were not "directly pertinent" to the pricing in the subject contracts as Bristol operated its business and set those prices. The factors Bristol excluded in calculating prices under the subject contracts, the very ones at the base of controversy now, were not proven to have been omitted from, hence not pertinent to, Lilly's contracts. Only in such a setting could the governing words of limitation ("directly pertinent") have been meaningfully defined by *Lilly* for this Court's benefit. They were not.

That brings us to Judge Lasker's decision which gave rise to this appeal. Whereas the *Hewlett-Packard* court merely determined that direct manufacturing costs were accessible to the government (as Bristol has conceded from the very beginning of this litigation), and whereas the *Lilly* court bent over backwards to legitimize the true goal of the Comptroller General's request for access to Lilly's records, and whereas the *Abbott* court felt constrained only by the imperative of *stare decisis* to follow in the footsteps of *Lilly* (implying it would have decided even *Lilly* differently), Judge Lasker squarely confronted the issue of whether particular expenses (research and development, marketing and promotion, distribution, general and ad-

ministrative) were directly pertinent to the four specific contracts entered into between Bristol and the government. He properly stated the issue before him as "regarding the scope of Staats' contractual right to inspect Bristol's books and records."¹⁷ For, although the access-to-records clause required to be incorporated into government contracts such as the four in issue find their origins in statute, they are nevertheless contractual provisions.

It should be noted that Judge Lasker was not unmindful of "recent attempts by the GAO [appellant Staats] to conduct a comprehensive study of pricing practices in the pharmaceutical industry and the refusal of the drug manufacturers voluntarily to supply the information requested."¹⁸ However, that was not a keystone of his decision and does not becloud its substantive basis. He aimed directly at the heart of the government's claim, its "bottom line" theory.

The Government's theory has far-reaching implications. . . . If the Government's interpretation of the access to records clause is correct, Bristol will be required to make available virtually all of its books and records, because although it is impossible to trace the use of Government dollars, those dollars contribute to the fund from which all of the company's expenses are paid. 428 F.Supp. at 1390.

In holding that the government's position is inconsistent with the language of the access-to-records clause, he rejected the "bottom line" theory as producing a result that would be beyond the scope of appellant Staats's authority, whether contractual or statutory. In applying the restric-

¹⁷ 428 F.Supp. at 1388.

¹⁸ *Id.* at 1389.

tive, operative words “directly pertinent” and “involving transactions related to the contract” to the facts before him; he properly decided that such words of limitation do not permit the unusual and unfettered government inspection of Bristol’s business records that appellant Staats here seeks.

All of the underscored phrases [“directly pertinent”, “involving transactions related”] are words of limitation. It is a distortion of the language to argue that these words permit GAO officials to discover virtually everything there is to know about the structure of the contractors’ business. *Id.* at 1390.

Unwilling to rule in a legal vacuum or to apply abstract legal theory without relating it to the facts at hand, he rejected the government’s “bottom line” theory, in favor of one that considered “the specific questions which arise in the context of each case” (*id.* at 1391). And, recognizing that *Hewlett-Packard* merely stood for the proposition that direct production costs are among those which are directly pertinent to the cost of performing a contract, whether or not those costs are part of the negotiation process and whether or not they are assigned to the subject products or contracts by the supplier, he held *Hewlett-Packard* to be “of no positive aid” in resolving the instant controversy, particularly in view of the fact that Bristol all along had agreed to provide records representing those costs. It is impossible to fault his logic.

C. Appellant Staats’s access to Bristol’s records must be limited as a matter of contract.

Appellants make much of the fact that the demand and dispute leading to this appeal occurred after *Hewlett-Packard*. Because of that chronology, appellants argue,

Bristol must have been aware of appellants' interpretation of the access-to-records clause, and therefore voluntarily entered into the subject contracts knowing full well that the government would take the position that it has.

Such an argument strains to the point of breaking. It would be difficult enough to predict with any degree of confidence that Bristol would have entered into the subject contracts at all if it knew that to do so would subject the totality of its books and records to limitless snooping by the federal government. To further maintain, however, that it was forewarned of that because of the opinion of *Hewlett-Packard* grossly misreads that case. It clearly foretold only that GAO's right to access would be confined to records so "directly pertinent" as those reflecting production costs. In polar contrast to the expectations appellants would now in retrospect base upon it, *Hewlett-Packard* was, if anything, assurance to Bristol that the contracts it was about to enter into with the government would preserve inviolably the confidentiality of its data regarding costs that it did not factor into fixing its prices under those contracts, and which were not incurred in their performance. That is the *Hewlett-Packard* gloss upon the subject contracts.

As Judge Lasker summed up the contract issue,

There is an additional important reason for rejecting the government's interpretation. Although the access to records clause has its origins in statute, it is nevertheless a contractual provision. We are thus confronted with the task of construing the contracts, a task which turns on the intent and understanding of the parties regarding the import of the access to records clause at the time the contracts were entered. The government's position is particularly unrealistic when viewed in this light. It is

inconceivable that Bristol, or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO. As a matter of contractual construction, the government's argument falls of its own weight. 428 F.Supp. at 1390-91.

D. The legislative history lends no support to appellants' position.

Appellants devote a section of their brief to the legislative history of the pertinent statutes. Although the cited excerpts from the deliberations of congress lend little assistance to resolving the issue here presented, to the extent they are enlightening they support Bristol's position.

After devoting nearly three pages to vacuous references to Congressman Hardy and certain passages accompanying the Senate bill relating to the subject statutes, appellants state, "it should make no difference whether the manufacturer allocates his costs to specific products for accounting purposes, or indeed whether he takes these costs into consideration in setting his prices" (Appellants' Brief, page 17). This conclusion highlights what has been appellants' misguided approach throughout this controversy. If Bristol neither allocated a particular expense nor took it into consideration in setting its price to the government under the subject contracts, nor incurred it in their performance, it cannot be "directly pertinent" to those contracts, and appellant Staats is not entitled to records reflecting it. Nothing in the legislative history cited by appellants demonstrates a contrary congressional intent.

Relying on certain language from the *Lilly* opinion, appellants attempt to advance their case by leaving statutory interpretation and construction of legislative history to that court. Nonetheless, even the *Lilly* majority, address-

ing the *Hewlett-Packard* decision, pointed out that "it is hard to imagine anything more directly related to a contract than the cost of producing the items covered by it or the matters going into the makeup of the price." Bristol agrees that a government contractor does not, for corporate accounting purposes, have to assign a particular cost to the contract in order for it to be "directly pertinent" if, in fact, the price it sets is calculated to absorb the cost in whole or in part. The very language appellants cite concerns costs the contractor is required to incur in producing the item sold under the contract which he factors into the contract price. The proof here, however, is that the only expenses Bristol plans its government contracts prices to cover, or incurs in carrying them out, are those specified at pages 8-12 and 14 above. Records concerning them are not at issue; only those relating to non-pertinent costs.

A mere perusal of the language quoted in appellants' brief reveals their misplaced reliance. In each example, the quotations upon which appellants rely tie the accessible records to "a contract", "items included in the contract", "of that contract" or "how much it cost him to perform that contract".

Appellants also seek solace in their own interpretation of the statute which the Comptroller General is charged with administering. But an agency cannot arrogate to itself authority that is not granted to it by statute. While the contemporaneous interpretation of a statute by any agency may be accorded some weight where a statute is ambiguous and reasonably subject to alternate interpretations, the agency's self-serving construction should not be accorded any weight where the language of the statute is clear and contrary to it. To hold otherwise would reduce the results of the legislative function to worthless scrap, *Shea v. Vilpando*, 416 U.S. 251, 262 n.11 (1974).

Reliance by appellants (at page 20 of their brief) upon the statement of Robert Keller, then general counsel to the General Accounting Office, for their interpretation of the statute is misplaced. Mr. Keller himself stated:

It is our position that the contract clause and the statute give us the right to examine the cost records of the contractor and other pertinent data that relates to the items *included in the contract . . .* (emphasis added).

That congress is aware of the *Hewlett-Packard* decision is of no moment in view of the import of that decision, *supra*, pages 15-16, 24-25.

Judge Lasker put the entire controversy in proper perspective when he concluded, at 428 F.Supp. 1391 (emphasis is ours):

Having rejected the government's position, it remains to determine the appropriate scope of the Comptroller General's examination. He is, of course, entitled to examine all "directly pertinent records involving transactions related to the contract." Although these words give general guidance, they do not provide answers to the specific questions which arise in the context of each case. We agree with the government that the issue should not depend entirely on a contractor's *bookkeeping method*, i.e., whether it does or does not assign particular costs to particular contracts or products. However, we do not understand this to be Bristol's contention. As set forth above, Bristol allocates only the direct costs of manufacture by product. These are among the costs it offers to make available, but they are by no means the limit of its offer. Rather, Bristol is willing to provide all records relating to *manufac-*

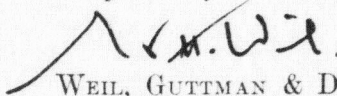
turing costs and the pricing of the products sold to the government. The specific list of items Bristol offers to make available, set forth at page 1389, *supra*, appears to reflect a responsible and reasonable effort to distinguish "directly pertinent" matter within the meaning of the access to records clause. It represents a sensible point at which to draw the line.

CONCLUSION

The district court's decision should be affirmed.

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Respectfully submitted,



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Service of three ③ copies of the within
is admitted this 8th day of Feb. 19.80

U.S. Attorney Office.

SDNY
By: Narmi Ricci Sudewald
Counsel for Defendant and
Intervenor-Defendant

Service of three ③ copies of the within ^{typical}
is admitted this day of 19.

